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SUBJECT: LEBANON: PARIS III AND ECONOMIC REFORM PLANNING  
CONTINUE

Classified By: Ambassador Jeffrey D. Feltman for reasons 1.4 (b) and (d).

SUMMARY

1. (C) A team at the Ministry of Finance is actively planning the GOL strategy for Paris III, designing an economic reform framework amidst a hostile political environment, and seeking to transform their plan into a sustainable economic policy structure. The reform plan should be final in early December. Lebanon's greatest needs are debt relief and long-term technical assistance programs. The team identified niche areas where increased U.S. assistance would be most helpful. Finance Minister Azour wants to have the IMF involved in the reform process. End Summary.

A STRATEGY AND A VISION  
AMIDST POLITICAL DETERIORATION

2. (C) Finance Minister Azour, in a November 21 meeting that was cut short by news of the assassination of Industry Minister and MP Pierre Gemayel, told the Ambassador, DCM and emboffs that planning for the Paris III donor conference continues, both in Paris and in Beirut. It includes political consultations with Lebanese opposition figures. The most helpful message the United States could disseminate, Azour told us, is that the USG believes that the donor conference will move ahead. The documents provided by the GOL to French coordinator for Paris III Jean-Pierre Mr. Jouyet detailed an updated GOL five-year fiscal reform program. (Note: Our Ministry of Finance interlocutors provided us a copy of the 35-page program of statistics and measures was was given to Jouyet. The plan has a five-year perspective. Azour said that PM Siniora has already seen it, and it will be circulated to Cabinet members for their comment. End Note.)

3. (C) The program was written by an interagency team from the Ministry of Finance, Ministry of Economy and Trade, the Central Bank, the Council for Development and Reconstruction, and the Prime Minister's Office. Political problems have focused attention elsewhere, but the MOF is progressing with its reform program, taking internal comments, exchanging notes with donors, and consulting regularly with the international financial institutions, and with the finance ministers of the Gulf Arab states. The Cabinet has reviewed the program once since the July-August war. It is an updated version of the reform program presented in late March of this

year.

14. (C) Azour is seeking a major turnaround, from crisis to high growth, through phased aid with immediate impact and donor supervision of reforms, including by the IMF. The program calls for reducing debt to a sustainable level over five years but does not explicitly detail how that would be achieved. Improved tax collection and tax increases would build revenues over the same period, as would increased bill collection for utilities. The plan would also stem expenditures via a civil service hiring freeze, production efficiency in the heavily subsidized power sector, and the closure of the Fund for the Displaced and the Council for the South which together spend USD 350 per year. The plan also details public finance and financial sector laws pending in Parliament, privatization plans for the telecom and power sectors, and reform of the pension system. It projects increased efficiency in expenditures to improve the quality of GOL social services.

15. (C) Azour is rushing to translate his program into policy before a change in government. He hopes to turn the program into a vision and strategy for the future, through a policy document approved by the Cabinet with reform tools embedded in various ministries and sectors. This would translate into an economic policy able to transcend changes in government, and reforms less dependent upon political will to proceed. In addition to the overall economic plan presented to Jouyet in mid-November, a sectoral plan will be ready in early December. The sectoral plan will be the basis for a seminar with the relevant ministries and outside experts. Like the overall plan, these sectoral plans will go to the Cabinet for approval and become policy. A special social agenda, a supporting program of governance laws to improve the

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efficiency of government services, and a ten-year growth and economic vision statement will go through the same cabinet approval process.

TOP REQUESTS FOR PARIS III:  
DEBT RELIEF AND TECHNICAL ASSISTANCE  
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16. (C) At a second meeting on November 24 the Finance Ministry team working on Paris III, including World Bank detailee Bassam Ramadan and the six-person UNDP Economic Unit led by Rola Rizk, clarified their primary goal for the conference to the DCM and econoffs. The objective is to reduce the debt-to-GDP ratio within 5 years to a point where it remains on a overall downward trend even if in some years the budget surplus is small or negative. The document they provided to Jouyet predicts a drop in the debt-to-GDP ration from 181 percent to 144 percent in 5 years, and officials indicated that even this will require grants and low interest rate loans.

17. (C) The second goal is targeted, medium-term technical assistance programs aimed at maintaining momentum for economic reform, as well as IFI and donor involvement, which will transcend likely changes in government. Ramadan passed econoffs a proposal for a Technical Assistance Trust Fund for Capacity Development with 17 priority areas where medium-term technical assistance programs at the relevant ministries would support continuous progress toward stronger programs and more efficient and effective GOL services. The areas prioritized for technical assistance include:

- Public financial management
- Government effectiveness
- Public procurement
- Donor coordination
- Banking
- Private sector development
- Trade facilitation
- Agriculture and irrigation

--Housing  
--Water and sanitation  
--Environment  
--Education  
--Gender  
--Health  
--Labor  
--Pensions and health insurance  
--Creation of a social safety net

FUND INVOLVEMENT  
AND CONDITIONALITY  
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18. (C) Our MOF interlocutors said Paris III will take place with the active involvement of the International Monetary Fund (IMF). Long-term technical assistance programs from the IMF are ongoing in Lebanon. A formal IMF program is still a possibility, according to MOF officials, but would require a request from the GOL, strong international assistance, and a phased structure to ensure reforms are implemented. Azour is now trying to obtain guarantees from the IMF that if asked for a program the IMF would say yes, before he brings a proposal for a program to the cabinet. He also wishes to reassure the IMF that the GOL will have plans prepared ahead of making that request. Nevertheless, it is unclear if in the end Azour will decide to request a program at all.

19. (C) Any conditionality at Paris III must be realistic. The GOL will be able to point to some progress, including the passage of bills currently before parliament, before it closes its session in late December. The timing for telecom license sales will not be right until the market value rises from its low just after the war, but the GOL will be able to point to key steps made in the preparation process. World Bank technical assistance programs are ongoing in debt management and pension reform, and IMF assistance programs continue on tax and expenditure reform.

PRIORITY AREAS FOR U.S. ASSISTANCE  
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110. (C) Debt service is the largest part of government expenditures, about 38 percent, and reducing the debt to GDP

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burden is a critical need identified by the IMF. Aside from direct cash contributions there is little U.S. aid available that can reduce government expenses, and some items, such as defense equipment that will require maintenance, can actually increase required spending.

111. (C) Salaries and subsidies to civil servants and the military are the second largest expenditure at about 28 percent. The military pension system averages about 115 percent of salary, among the highest in the world. The GOL spends a lot of money supporting private services through subsidies to the military and civil servants. Such subsidies can be used at private schools and hospitals, indicating that improving public services could decrease GOL spending. Providing technical expertise to establish a social safety net would help the GOL save money over the long run. A two-to-three year program of technical assistance on health care finance might be particularly useful. Technical assistance to help reduce government spending on special subsidies to the military would further cut costs. Creation of a social safety net would make possible the reduction and reallocation of civil service personnel.

112. (C) Treasury transfers to the Lebanese electric utility EDL and other entities make up another 20 percent of expenditures. Technical assistance that would improve EDL efficiency would reduce this cost.

113. (C) Miscellaneous expenditures make up 9 percent, and technical expertise to improve the transparency and

efficiency of GOL spending would help. Capital expenditures make up just 5 percent. MOF officials said that if donors would waive the requirement for a local partner, take on 100 percent rather than the customary 80 percent of the costs, and pay for items such as expropriation of land, such steps could reduce the GOL's capital expenditures.

COMMENT

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¶14. (C) The UNDP technical assistance program, which pays the salaries of key advisors to several ministries, seems to be responsible for most reform progress to date, as well as drafting the current economic program. By enabling the ministries to hire on contract and at competitive salaries qualified and motivated professional advisors who cannot be fired and replaced at will, the UNDP technical assistance program has created an effective group with the influence to push for reform despite any change in government. Given the success of this program, additional investments in medium- or long-term technical assistance programs seem an excellent way to support economic reform. End Comment.

FELTMAN